BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

In the matter of: TOWER EQUITIES, INC. 8141 N. Main Street Dayton, Ohio 45415-1747 CRD #16195 PHILIP A. LEHMAN Tower Equities, Inc. 8141 N. Main Street Dayton, Ohio 45415-1747 CRD #1345038, Respondents.	DOCKET NO. S-03439A-00-0000 **DIVISION'S POST-HEARING MEMORANDUM**

The Securities Division (the "Division") of the Arizona Corporation Commission (the "Commission") hereby submits this post-hearing memorandum. The Division incorporates by reference in this Post-Hearing Memorandum, the stipulated "substantive facts" numbered 1-38, of the parties' Joint Pre-Hearing Statement dated May 30, 2001. (The stipulated substantive facts will be referred to in this memorandum as "Stipulation ___.") Additional facts are found in the exhibits that were admitted into evidence during the hearing on June 13, 2001. (These facts will be cited in this memorandum as "EX S-___.")

ARGUMENT

Respondents have conceded that grounds exist for revocation of the Arizona securities salesman's registration of Philip A. Lehman, and Respondents have not argued against such revocation. Accordingly, that part of the relief the Division has requested ought to be granted.

As to Respondent Tower Equities, Inc. ("Tower"), three issues exist. First is whether there are sufficient grounds to revoke Tower's dealer registration under A.R.S. §44-1961(A)(9), which

provides for suspension or revocation "if the Commission finds that . . . [t]he dealer is permanently or temporarily **enjoined by order**, judgment or decree of **an administrative tribunal or** a court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the sale or purchase of securities." (Emphasis supplied.) Respondents admit that the SEC has issued an order that, among other things, directs Tower to cease and desist from committing "willful" securities fraud. (EX S-10; Stipulations 6, 7, 9.) But Respondents contend that the SEC order did not "enjoin" Tower as that word is used in Section 44-1961(A)(9). This is purely an issue of statutory interpretation – there are no facts in dispute as to this first ground that the Division asserts for revocation of Tower's Arizona dealer registration. The Division contends that the SEC order subjects Tower to revocation of its dealer registration in Arizona, as will be argued in detail below.

The second issue between the parties relates to the alternative ground the Division asserts for revocation of Tower's dealer registration. The alternative ground is found in A.R.S. § 44-1961(B), which provides in relevant part: "It is sufficient cause for . . . revocation or suspension of registration of a dealer as provided in this section [1961], if the dealer is a . . . corporation . . ., that . . . an officer or director of the corporation . . ., **or a person controlling . . . the dealer**, has been guilty of any act or omission which would be sufficient ground for denying or revoking the registration of an individual dealer." (Emphasis supplied.) There is no dispute by the Respondents that the SEC order is sufficient proof that Philip Lehman has been guilty of fraudulent acts and practices in connection with the sale of securities, and no dispute that the SEC suspended Lehman from the securities business for a period of at least six months. There is no dispute by the Respondents that such fraudulent acts and such lengthy suspension would each be sufficient ground for denying or revoking the registration of an individual dealer under the Arizona Securities Act. The only issue between the parties with respect to this alternative ground for Tower's revocation is whether the phrase "a person controlling the dealer" includes Philip Lehman in the circumstances shown in this case. The Division believes the evidence shows that Phil

Lehman was a person controlling Tower at the time of the fraudulent conduct as found by the SEC (EX S-10; Stipulations 4 and 5), and that such control is sufficient under the statute. Alternatively, the Division believes the evidence shows that Phil Lehman remains a person controlling Tower today, as will be argued in detail below.

The third issue for the Hearing Officer's decision is whether to recommend to the Commission that Respondent Tower's dealer registration be revoked. The Division submitted copies of prior Commission orders which support the Division's request that Tower's registration be revoked (EX S-27 – S-31), and the Division believes that the evidence shows that revocation is the most appropriate course of action, as discussed in detail in this Memorandum.

1. Tower has been enjoined by order of an administrative tribunal from continuing to commit willful fraud in connection with sales of securities.

In Arizona, if a statute is clear and unambiguous, it must be given effect without resorting to any rules of statutory construction. *Lewis v. Arizona Dep't of Economic Security*, 925 P.2d 751, 186 Ariz. 610 (App. Div. 1, 1996). Section 1961(A)(9) is clear on its face. It contains the verb form "enjoined," which in this context is synonymous with "forbidden" or "prohibited." Tower's registration as a dealer in Arizona is subject to revocation pursuant to A.R.S. § 44-1961(A)(9), because Tower has been permanently enjoined by order of an administrative tribunal (the SEC) from engaging in or continuing its fraudulent conduct in connection with the sale or purchase of securities (EX S-10). The word "enjoined" does not require a paper captioned "injunction." The Legislature clearly used the word "enjoined" in a way that says it is possible to be "enjoined" by an "order" of an administrative agency -- i.e., a cease and desist order like the one issued by the SEC in Tower's case.

Alternatively, if the statute is viewed as unclear, the principles of statutory construction nonetheless require the conclusion of law urged by the Division. In Arizona, a "statute or regulation is to be given such an effect that no clause, sentence or word is rendered superfluous, void, contradictory, or insignificant." *Marlar v. State*, 666 P.2d 504, 136 Ariz. 404 (App. Div. 1,

1983), *see also Guzman v. Guzman*, 854 P.2d 1169, 175 Ariz. 183 (App. Div. 1, 1993). Significantly, the phrase "an administrative tribunal or" was just added to paragraph (A)(9) of Section 1961 by Laws 2000, Ch. 108, § 301. Prior to that amendment the paragraph referred only to an "order, judgment, or decree of a court of competent jurisdiction." (A copy of the black lined version of paragraph (A)(9) of the statute, showing the amendment, was appended to the Joint Pre-Hearing Statement.) Respondents' position that only an "injunction" can form the basis of a revocation under Section 1961(A)(9), would nullify the action of the Legislature when it added the phrase "an administrative tribunal or" to the statute last year, because only a court can issue an "injunction," while an administrative agency issues "orders." *See, e.g.,* A.R.S. §§ 44-1963(A) and 44-1964, in which Commission actions regarding dealer and saleman registrations are called "orders." Respondents' position would render the phrase "order . . . of an administrative tribunal" in Section 1961(A)(9), as amended, superfluous. Arizona principles of statutory construction, as well as respect for the action of the Legislature when it amended the statute last year, require rejection of Respondents' position. The only way to read the statute which gives effect to every word and clause in it, is the one urged by the Division: that "enjoined" is synonymous with "forbidden" and "prohibited" and does not require an "injunction."

Finally, the Hearing Officer is respectfully urged to consider decisions such as *National Labor Relations Board v. Colten*, 105 F.2d 179 (6th Cir. 1939), a copy of which was handed up by the Division during the hearing on June 13. In that case the Sixth Circuit decided that an administrative cease and desist order is "of the nature of an injunction." 105 F.2d at 183. *See also, Gelb v. Federal Trade Com'n*, 144 F.2d 580 (2d Cir. 1944) (stating, at 581, that a cease and desist order by the FTC had "enjoined" particular practices of the regulated person and that such order was, in effect, an "injunction"). Administrative cease and desist orders are issued based upon findings made by an agency as required by the statute that the agency administers, while a court may issue an injunction based upon particular findings (e.g., that the plaintiff has "no adequate remedy at law"), which were developed through the history of equity jurisprudence.

Thus an administrative cease and desist order is not precisely "the same" as an injunction; however, it is the administrative law analog of an injunction. Accordingly, it is entirely reasonable, as well as required by the principles of statutory construction discussed in the preceding paragraph, to read the word "enjoined" in A.R.S. § 44-1961(A)(9) as describing the action by the SEC against Tower in the present case.

2. The phrase "a person controlling the dealer" in A.R.S. § 44-1961(B) includes Philip Lehman, in the circumstances shown in this case.

Tower's dealer registration should be revoked based upon the first ground advanced by the Division, as discussed above, which requires no finding with regard to "control" of Tower.

But a second ground for revocation of Tower's registration exists pursuant to Section 1961(B) of the Arizona Securities Act. Specifically, because Lehman was a person controlling Tower at the time of the fraudulent conduct as found by the SEC (EX S-10), Tower's registration as a dealer is subject to revocation in Arizona pursuant to A.R.S. § 44-1961(B). Alternatively, because Lehman remains a person controlling Tower today, Tower's registration as a dealer is subject to revocation pursuant to A.R.S. § 44-1961(B).

Subsection 1961(B) provides that the existence of the SEC order, by itself, is sufficient proof that Lehman and Tower have been guilty of fraudulent acts and practices in connection with the purchase or sale of securities, for purposes of determining that Tower is ineligible for continued registration in Arizona. The fact that there was control at the time when the fraudulent conduct occurred is a sufficient basis for application of Subsection 1961(B); otherwise it would be too easy for perpetrators to avoid the consequences of their conduct, as Respondents are attempting to do here, by transferring nominal ownership of stock to family members. Similarly, the court in *SEC v. Quing N. Wong*, 252 F.Supp. 608 (D. Puerto Rico 1966), interpreting Section 36 of the Investment Advisers Act of 1940, held that the phrase "a person serving or acting . . . as officer or director" meant that the person must have been so serving or acting at the time of the wrongful conduct, rather than at the time the SEC commenced action against the person.

Alternatively, the Division believes that the evidence shows that Philip Lehman remains a person controlling Tower today. Regarding the judicial construction of the word "control," Respondents cite a federal decision that was rendered in a case of private litigation seeking an award of damages through application of Section 20(a) of the Securities Exchange Act of 1934. Different standards apply to government regulatory actions than to private litigation for damages. *See SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974) (Section 20(a) does not even apply to SEC regulatory actions because the section was meant to specify the liability of control persons to private litigants seeking damages). Moreover, Respondents have mis-quoted the standard, which is that the control person must have had "some kind of participation *in the activities of the controlled person which are claimed to be violative of the securities laws*" for liability to attach. *Christoffel v. E.F. Hutton & Co.,* 588 F.2d 665, 668 (9th Cir. 1978). Obviously, Lehman was up to his elbows in the fraudulent activities here, as the SEC found; therefore *Christoffel* lends no support to Respondents' position.

In addition, in Arizona the courts interpret the securities laws differently than the federal courts, applying a central principle of the Arizona statutes: "the Arizona policy of protecting the public from unscrupulous investment promoters." *Siporin v. Carrington*, Slip Op. at 16 (1st Dep't April 19, 2001); see also *State v. Baumann*, 610 P.2d 38, 45, 125 Ariz. 404 (1980) (*en banc*), quoting *Jackson v. Robertson*, 368 P.2d 645, 648, 90 Ariz. 405, 409-10 (1962) (Arizona securities statutes should be applied in a way that is preventive if possible, remedial only if necessary). The federal securities laws are designed to make sure investors receive full disclosure of facts, while Arizona's are more highly protective of investors. *North Star International v. Arizona Corporation Com'n*, 720 F.2d 578 (9th Cir. 1983). This is why the Division conducts merit reviews of new issues of securities, while the SEC does not.

Finally, courts have recognized that effective control may exist even where nominal stock ownership, and officer and director titles, rest in hands other than the control person's. E.g., *Ellison v. American Image Motor Co.*, 36 F.Supp.2d 628, 638 (SDNY 1999) ("Stock ownership is

not the exclusive means of exercising control . . . Other means include business relationships, interlocking directors, *family relationships*, and the power to influence and control the activities of another) (emphasis supplied, citation omitted). The word "control" has been interpreted as requiring only some indirect means of discipline or influence short of actual power to direct. *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *accord, Richardson v. MacArthur*, 451 F.2d 35, 41-42 (10th Cir. 1971). In *Myzel*, the finding of control was based upon the finding that the control person was a first cousin of the four owners of a family-held corporation as well as a "financial consultant and advisor" to the company. Other decisions in which family relationships were significant factors in finding control include *MTC Electronic Technologies Shareholders Litigation*, 898 F.Supp. 974, 984 (E.D.N.Y. 1995) (son and nephew of the two most powerful officers of the company); *MacClain v. Bules*, 275 F.2d 431, 436-37 (8th Cir. 1960) (individual who had organized the company and issued the stock to himself and "members of his family" held to control company despite having had "someone else" take over the title of president); *Health Management, Inc. Securities Litigation*, 970 F.Supp. 192, 207 (E.D.N.Y. 1997) (marriage evidenced the wife's control status where husband and wife owned a total of 11.4% of the company); *Mader v. Armel*, 461 F.2d 1123, 1125-26 (6th Cir. 1972) (director of a company who, with his family, invested heavily in the stock of the company found controlling).

In the present case, the evidence regarding Lehman's present control of Tower is as follows:

1. Lehman founded the company and was its sole shareholder for the 17 years of its life prior to the SEC order. EX S-10, S-4; Stipulations 4, 5. Lehman was also chairman, vice president and chief compliance officer of Tower from at least January 1, 1997 until October 1, 2000. Id.

2. After being suspended from the securities industry for nine months by the SEC (EX S-10), Lehman transferred nominal ownership of Tower's outstanding stock to his wife, son, stepson

and Kenneth Wiseman, who had been his chief financial officer and a director of Tower for the previous 15 years. EX S-33; Stipulations 26-31, 34.

3. Subsequently, Lehman's son left the company and his 16.66% share of the company's stock became treasury stock. EX S-8; Stipulation 33. This action had the effect of concentrating the voting control of the remaining shareholders, including Lehman's wife who now holds more than 50% voting control of Tower. Id.

4. Lehman's wife is not a securities professional. EX S-3 and S-6; Stipulation 29.

5. Lehman fought his proposed revocation by Ohio securities regulators, bringing three lawyers to the hearing (two of them from Chicago), and otherwise spending significant time and money fighting to stay in the securities industry. EX S-32. It is much more likely that he intends to continue conducting securities business through the company that he founded and developed over the past 17 years, which is still owned by his family and best friend, than that he intends to apply to some stranger to employ him as a junior salesman. Accordingly that is the inference that should be drawn from the evidence.

Based upon the foregoing facts of record, the Division submits that Lehman remains a person controlling Tower, and accordingly Tower's Arizona dealer registration is subject to revocation pursuant to Section 44-1961(B). If Tower's registration is not revoked, we will have a dealer registered and operating here in Arizona, under the direction and control of an individual who committed blatant, willful securities fraud in connection with four prime bank and viatical schemes, over a two year period. This is clearly what the Legislature intended to prevent when it enacted Section 44-1961(B).

3. Tower's Arizona dealer registration ought to be revoked.

The third and last issue for the Hearing Officer's decision is whether, in light of all the circumstances, Tower's dealer registration ought to be revoked.

The Division respectfully submits that revocation is the only appropriate course of action in this case. Philip Lehman was one of the creators and sponsors of the four fraudulent offerings, and

Respondent Tower was the underwriter of all of them. EX S-10, S-18, S-21, S-22, S-23. Lehman and Tower were directly responsible for writing the offering memoranda in which the fraudulent misrepresentations were made to investors. Id.; *see also* Stipulations 12, 13, 14, 17, 19, 21. Lehman invested none of his own money in these offerings (Stipulation 11), unlike a number of other Arizona salesmen who have been able to claim credibly that they were fooled by others into believing an offering was legitimate when they sold it. Lehman is without excuse. Tower and Lehman, among other things, told investors they could expect to earn returns of up to 100% within 25 days, or an annualized rate of 1,440 percent, with minimal risk. EX S-10; Stipulation 21.

Tower cannot credibly claim that Lehman acted alone in perpetrating these frauds. Kenneth Wiseman was also a "sponsor" of one of the four issues that the SEC found were fraudulent. EX S-18; Stipulation 35. The four fraudulent offerings were sold by Tower salesmen in at least 15 different states. EX S-24, pp. ACC 406-409; Stipulation 23. Because Philip Lehman was not registered in most of these states during the selling period (1997-98), other Tower salesmen must have been involved in the selling efforts. EX S-4.

The incomplete information that the firm has supplied concerning its Arizona accounts shows that, at most, six Arizona families will have to find a new registered representative if the firm's registration is revoked. EX S-24, p. ACC 410. Customers are not "harmed," but protected, when a dealer with a record of committing fraud is removed from servicing their accounts. The five Arizona-registered salesmen that Tower currently has associated, are all residents of distant states. EX S-5. Each has only one or two accounts in Arizona, and the incomplete information that Tower has supplied fails to show more than a negligible amount of business in those accounts. EX S-24, pp. ACC 411-424. Tower has failed to substantiate any likelihood of "harm" to customers or salesmen.

Respondents ask the Hearing Officer to draw inferences that cannot legitimately be drawn, from the actions of the SEC and the Ohio and Indiana securities regulators. Each of those regulatory bodies acts, in enforcement proceedings, in a quasi-prosecutorial role. Accordingly, the

principle of prosecutorial discretion applies, and no inferences may legitimately be drawn from those agencies' choices not to seek suspension of Respondent Tower's license. In addition, the SEC order was a consent order, and it is in the nature of settlement negotiations that the ultimate settlement typically reflects less severe sanctions than those to which the firm would have been exposed had there been a full hearing. Further, the SEC, Ohio and Indiana all operate under statutes other than the Arizona Securities Act. Arizona's securities laws are to be applied with the highest level of protectiveness toward investors. Consequently the sanctions applied in other jurisdictions do not impose a ceiling upon the sanctions that may be applied in Arizona.

Respondents have cited Commission Decisions 63217 (Zanowski), 63243 (MG Gold), and 62991 (Successful Finance, Inc. and Mary Kersey) in support of their contention that revocation would be excessive here. While it is true that such decisions did not revoke anyone's registration, the reason for that omission is simply that the respondents were all unregistered persons, so no revocation was possible. The Division's Exhibits S-27 through S-31 show that revocation is the sanction the Commission commonly employs in cases such as the present one.

Finally, the facts that there were no Arizona investors in the four frauds, and that Tower returned the investors' funds during the pendency of the SEC investigation, are not relevant here. Tower is a dealer which committed securities fraud in 15 states over a two-year period, in connection with four issues. As expressed in A.R.S. § 44-1961(A)(9), Arizona need not permit Tower to remain registered here and wait until Arizona residents have been defrauded before taking action. As our Supreme Court held in *Jackson v. Robertson*, 368 P.2d 645, 648, 90 Ariz. 405, 409-10 (1962): "It is the capacity for harm and danger to the public, as well as accomplished fraudulent transactions, to which the Securities Act is directed. The Act is designed to be prophylactic if possible, remedial only if necessary." Indeed, the licensing provisions of our Securities Act are primarily aimed at *preventing* losses, by setting standards for the competence and integrity of persons and firms who wish to participate in the securities industry in Arizona. The SEC order and other facts cited above, prove that Tower lacks such competence and integrity.

Dated this 29th day of June, 2001.

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